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Report of the Court of Auditors for 2016



EUROPEAN
COURT
OF AUDITORS

Report on the annual accounts of the European Schools for the
financial year 2016
together with the Schools' replies

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EXECUTIVE SUMMARY

What is this report about?

I. The Court reviewed the consolidated annual accounts of the European Schools for the 2016 financial year in accordance with the Financial Regulation of the Schools. This review took place at the Central Office and in two Schools (Alicante and Karlsruhe), and covered both the accounts and the internal control systems (recruitments, procurements and payments). For the first time in 2016, the Schools contracted an independent external auditor to examine the accounts of five Schools prior to the consolidation procedure.

What did the Court find?

II. Two of the Schools and the Central Office did not prepare their annual accounts within the legal deadline. Numerous errors were found, notably regarding the calculation and booking of provisions for employee benefits and the recording of payables and receivables. Most of the errors were corrected as a result of the review of the final version of the accounts. They constitute weaknesses in the accounting procedures.

III. Our review did not reveal material errors in the final consolidated financial statements for 2016.

IV. The payment systems of the two selected Schools showed a limited number of weaknesses while the control environment in the Central Office was weaker.

V. In addition to a lack of documentation for recruitment procedures, the Schools overused exceptions to the selection procedure for administrative and ancillary staff.

VI. The Court also found several weaknesses in procurement procedures and inadequate monitoring of interinstitutional framework contracts.

VII. As a result, the Court was unable to confirm whether the financial management had been performed in accordance with the Financial Regulation¹ and its Implementing Rules² and the Staff Regulations³.

What does the Court recommend?

VIII. The Board of Governors and the Central Office and the Schools should take immediate action to implement a series of recommendations made in this and previous years' reports to improve the accounting and internal control systems. In particular, the Court recommends that the Schools correct the weaknesses detected in the accounting procedures and continue to provide training and support to those involved in the preparation of the accounts. As regards internal control systems, the Court reiterates its recommendations for improving recruitment, procurement and payment procedures.

¹ Financial Regulation of 24 October 2006 applicable to the budget of the European Schools - Ref: 2014-12-D-10-en-1.

² Rules for implementing the Financial Regulations - Ref: 2014-12-D-11-en-1.

³ Regulations for Members of the Seconded Staff of the European Schools (Ref: 2011-04-D-14-en-5), Service Regulations for the locally recruited teachers in the European Schools (Ref: 2016-05-D-11-en-1), Service regulations for the administrative and ancillary staff (AAS) of the European Schools (Ref: 2007-D-153-en-7).

INTRODUCTION

Background

1. The primary legal basis for the European Schools ('the Schools') is the Convention⁴ which sets out their Statute. The financial and operational management of the Schools is carried out according to the Financial Regulation⁵ and its Implementing Rules⁶ and the Staff Regulations⁷ (which make up the 'General Framework').
2. The individual Schools are responsible for their annual accounts⁸, and the consolidated annual accounts are drawn up by the Office of the Secretary-General of the European Schools ('the Central Office') and forwarded to the Court of Auditors under Articles 90 to 92 of the Financial Regulation of the Schools.
3. The appropriations available in the 2016 budget amounted to 297,7⁹ million euro (288,8 million euro in 2015). The European Commission's 2016 contribution was 177,8¹⁰ million euro (168,9 million euro in 2015).
4. By 30 November, under Article 94 of the Financial Regulation of the Schools, the Court sends its annual report, together with the replies to the Council, the Parliament, the Commission and the Board of Governors, which is responsible for giving discharge.

⁴ Convention defining the Statute of the European Schools – (OJ L 212, 17.8.1994, p. 3).

⁵ Financial Regulation of 24 October 2006 applicable to the budget of the European Schools - Ref: 2014-12-D-10-en-1.

⁶ Rules for implementing the Financial Regulations - Ref: 2014-12-D-11-en-1.

⁷ Regulations for Members of the Seconded Staff of the European Schools (Ref: 2011-04-D-14-en-5), Service Regulations for the locally recruited teachers in the European Schools (Ref: 2016-05-D-11-en-1), Service regulations for the administrative and ancillary staff (AAS) of the European Schools (Ref: 2007-D-153-en-7).

⁸ Articles 86, 88 and 89 of the Financial Regulation.

⁹ Consolidated Accounts of the European Schools, Ref: 2017-05-D-35-en-1.

¹⁰ Annual Report of the Financial Controller for the year 2016, Ref: 2017-02-D-14-en-2.

Changes in the Financial Regulation and in the accounting / control environment

5. In 2016, for the second time, the Schools prepared their accounts on the basis of the accruals accounting principles set out in the International Public Sector Accounting Standards (IPSAS). The new accounting / financial system has been operational since 1st January 2015; it provides the technical means to address several weaknesses reported repeatedly by the Court (e.g. weaknesses in the consolidation process, no automatic link between the accounting and payment systems and inefficient financial circuits). In 2016, the link between the accounting software and online banking facilities was implemented in the Schools in Luxembourg and Varese¹¹. Further Schools were added in 2017¹² and the link is now operational in all fourteen Schools.
6. In April 2016, the Board of Governors adopted new *Service Regulations for Locally Recruited Teachers in the European Schools*¹³. These Regulations entered into force on 1 September 2016 and replaced the *Employment Conditions for Locally Recruited Teachers*.
7. During 2016, several workshops were organised on risk management, and guidance on risk management was also issued. All fourteen Schools now have a risk register, although the quality of information varies among Schools. At the end of 2016, the overall risk register of 32 generic risks applicable to all European Schools was reduced to a register of 10 major risks¹⁴.
8. In order to reinforce procurement procedures, the Central Office issued guidelines on procurement in 2016 and established a procurement network. Moreover, the procurement cell in the Central Office was enlarged to three full-time-employees¹⁵.

¹¹ Annual Report of the Financial Controller for the year 2016, Ref: 2017-02-D-14-en-2.

¹² The Alicante, Bergen, Frankfurt, Karlsruhe and Munich Schools.

¹³ Service Regulations for Locally Recruited Teachers in the European Schools - Ref: 2016-06-M-2/KK.

¹⁴ Annual Report of the Financial Controller for the year 2016, Ref: 2017-02-D-14-en-2.

¹⁵ Annual Report of the Financial Controller for the year 2016, Ref: 2017-02-D-14-en-2.

9. The working group¹⁶ for the revision of the Financial Regulation drafted a revised Financial Regulation which focussed on financial governance, i.e. the centralisation of the functions of Authorising Officer and Accounting Officer, a clarification and rationalisation of the budgetary principles and an alignment of the procurement rules with the rules applicable to the EU institutions. Moreover, the current Financial Regulation will be merged with its Implementing Rules. The Court has issued an opinion on the proposal¹⁷.

10. In 2016, the Commission's Internal Audit Service (IAS) carried out a limited review of the Governance of Security in the Central Office and in the Brussels IV and Munich Schools. It also performed an audit of IT controls over accounting and budget execution and concluded that the implementation of these controls was not effective and efficient.

Engagement, scope and approach

11. The Court's responsibility is to issue an annual report on the consolidated annual accounts¹⁸.

12. It conducted its review in accordance with the International Standard on Review Engagements (2400). This standard requires that the review should be planned and performed so as to obtain limited assurance as to whether the accounts as a whole are free of material misstatement. A review is limited primarily to inquiries into European School personnel and the analytical procedures applied to financial data and thus provides less assurance than an audit. The Court did not audit the consolidated accounts, and, accordingly, it has not expressed an audit opinion on them.

13. The Court also reviewed the control systems and the individual accounts of the Central Office, and two of the fourteen Schools (Alicante and Karlsruhe)¹⁹. In this context, it

¹⁶ Paragraph 8 of the 2015 Annual Report.

¹⁷ Opinion n°2/2017 available on the Court website : eca.europa.eu.

¹⁸ As required by Articles 93 and 94 of the Financial Regulation.

¹⁹ The budget appropriations in 2016 were: Central Office – 11,08 million euro, Karlsruhe – 11,52 million euro, Alicante – 12,09 million euro (*Source*: Annual Report of the Financial Controller for the year 2016, Ref: 2017-02-D-14-en-2).

examined staff recruitment, procurement procedures, payments, accounts and the application of the Internal Control Standards. In addition to our own findings, the Court drew on the reports by the Internal Audit Service of the European Commission and the Court reviewed the work performed by the independent external auditor of the European Schools, who examined the accounts of five Schools before the consolidation procedure took place.

14. The **Annex** shows the follow-up to recommendations made in the 2015 financial year (Frankfurt and Luxembourg I Schools and the Central Office).

ACCOUNTING

15. The Schools applied accruals accounting principles as set out in the IPSAS for the preparation of the 2016 accounts. Twelve out of fourteen Schools prepared their individual accounts within the legal deadline (31st March 2017). However, the Central Office only finalised its own individual accounts in late May 2017.

16. An external consultant assisted the Schools in preparing the consolidated accounts. The latest version received in early June 2017 included the corrections proposed by the independent external auditor for the five Schools audited as well as the corrections of the errors the Court identified in the Central Office and in the two Schools the Court visited.

17. The review revealed the following weaknesses:

- The report on the inventory of the Alicante School contained a systematic error concerning the accumulated costs and accumulated depreciation. However, this did not affect the trial balance and the financial statements. In addition, correct inventory figures were stated in the Accounting Officer's Declaration of Assurance.
- The Central Office and three of the Schools audited by the independent external auditor had calculated the provisions for employee benefits wrongly. The net underestimations, amounting to 343 000 euro, and booking errors have been corrected in the final accounts.
- In several cases, the Central Office and the Karlsruhe School had not recorded transactions correctly in the payables and receivables accounts. In Karlsruhe,

donations were recorded in a payable account, while in the Central Office, payables and receivables accounts included both credit and debit transactions.

- The Central Office and the two Schools visited did not apply consistently the methodology to estimate accrued charges.
- There was no evidence that the Central Office had performed a thorough analytical review of the consolidated accounts prepared by an external consultant.

INTERNAL CONTROL SYSTEM

Recruitment

18. The Central Office and the Karlsruhe School overused exceptions to the requirements of the full selection procedure for administrative and ancillary staff procedure. In one case, a selection procedure report in the Central Office contained numerous inconsistencies. In other cases, the documentation about residence and employment permits for personnel from non-EU countries and the checks on the teachers' qualifications was lacking.

Procurement

19. In the Central Office and in the Karlsruhe School, the evaluation procedures we examined were unclear and contained weaknesses which, however, did not affect the final ranking of the offers. In one case, an evaluation report included inconsistent marks and, in two other cases, the evaluation procedures were incomplete. For a procurement procedure performed on the basis of an urgent need, there was no initial request, no prior approval by the authorising officer and no evidence of price negotiations.

20. The Central Office did not properly monitor the interinstitutional framework contracts it signed on behalf of all the Schools. These contracts are concluded by the EU institutions and by the Central Office on behalf of the Schools, which can participate according to their needs. As there is an overall expenditure quota for the European Schools, the Central Office should monitor the consumption of this quota by the individual Schools. However, the Central Office had no information on either the participation of individual Schools in the contracts or on the consumption of the funds.

21. The management of extra-budgetary contracts is not clearly defined and might lead to risks for the Schools. In the Alicante School, the parents' association concluded and funded a catering services contract. The School provided technical support during the procurement procedure. However it also co-signed the contract and thus became liable for a contract that it had neither funded nor managed. In addition, the rules on procurement of the European schools were not followed, as the School considered that these rules did not apply to extra budgetary contracts.

Annual Activity Reports

22. The Central Office issued draft guidance to the Authorising Officers for drafting statements of Assurance and making reservations in their Annual Activity Reports²⁰. This guidance, which will be mandatory from 2018 onwards, also aims to harmonize and standardize the different formats used at present to report on the activities of the Schools and the implementation of the Internal Control Standards.

Payments

General

23. The Court's Annual Reports for the years 2012 to 2015 criticized the absence of an automatic link between the accounting and payment systems. Such a link was put in place in all Schools during the first half of 2017 (see also paragraph 5). However, the electronic payment systems connected with the accounting software cannot be configured in such a way as to accept only payments coming from the accounting software²¹. Therefore, although the automatic link is established, payments can still be manually introduced into the electronic payment system.

24. In order to mitigate the risk of making payments outside the accounting system, the Schools applied a double signature system in which each payment had to be signed by two

²⁰ None of the Schools made reservations in their Annual Activity Reports for 2016.

²¹ Paragraph 26 f) of the 2015 Annual Report.

staff members. In 2013²², the Secretary General set an indicative threshold of 60 000 euro above which one of the two signatories had to be the authorising officer. While this threshold was applied in the Central Office and in both Schools for the payments audited, the signature of the authorising officer was also requested more frequently in the Alicante School than in the Karlsruhe School for payments below the threshold. In addition, as individual banks apply different data storage policies, it was not always possible to obtain proof of the implementation of the double signature for all audited payments.

Sample of payments

25. Most errors found in payment transactions at the Central Office and in the two Schools visited related to the commitment or to the purchase order. In some cases at the Central office, there was no purchase order at all (only an invoice) or the purchase order was not valid as it had not been signed by the authorising officer. In two cases, commitments were established after the purchase order. In the Karlsruhe school, a commitment was established after the provision of the service and the reception of the invoice. The review also noted discrepancies between commitment and payment details.

26. Other weaknesses concerned the control environment: in one case at the Central office, the authorising officer validated the payment of his own mission expenses. In the Alicante school, overtime was paid to locally recruited teachers although timesheets certifying the numbers of hours actually worked had not been signed by the Director of the primary school and by the Director of the school, contrary to the applicable control procedure.

CONCLUSIONS

Accounting

27. The Court found significant weaknesses in the application of accruals accounting in the accounts of the Central Office and the Alicante and Karlsruhe Schools, in particular in the calculation and booking of provisions for employee benefits and the recording of payables and receivables. Material errors were corrected during the consolidation procedure.

²² Memorandum 2013-10-M-1-en-1/KK.

28. Based on the limited assurance review performed, the Court did not identify any material errors in the final financial statements for 2016.

29. Five Schools were audited by an independent external auditor, who expressed an unqualified audit opinion. The Court's examination of these audit reports and of underlying working papers did not reveal material weaknesses.

Internal control systems

30. While the internal control systems of the Alicante and Karlsruhe Schools showed limited weaknesses, there are still significant weaknesses in the internal control system of the Central Office. The audit reports of the independent external auditor also revealed significant weaknesses in the recruitment, procurement and payment procedures. The Court is thus unable to confirm that financial management was performed in accordance with the General Framework.

RECOMMENDATIONS

31. The Board of Governors, together with the Central Office and the Schools, should take immediate action to implement the following recommendations:

Accounting

32. The Court reiterates its recommendation from previous years that the schools should provide in-depth training and effective support for all those involved in the preparation of the accounts, in order to ensure that they are capable of meeting the requirements of accruals accounting under IPSAS and meeting the legal deadlines for issuing them. Moreover the weaknesses mentioned in paragraph 17 should be analysed and the possible effects on the 2017 accounts should be mitigated.

Internal control systems

Recruitment procedures

33. The Schools should reduce the number of exceptions applied to the full selection procedure for the recruitment of administrative and ancillary staff and duly document and justify them.

Procurement procedures

34. The Court reiterates its recommendation from previous years for the Central Office to provide more guidance to the Schools on planning and designing procurement procedures. In particular, the Schools should improve the documentation of procurement procedures in order to avoid any inconsistencies. The Central Office should supervise the conclusion and the implementation of interinstitutional framework contracts. The Schools should clarify the rules applicable to extra-budgetary contracts.

Payment procedures

35. The Court reiterates its recommendation from previous years that the Central Office and the Schools should implement payment procedures more rigorously for all types of financial transactions.

This Report was adopted by Chamber V, headed by Mr Lazaros S. LAZAROU, Member of the Court of Auditors, in Luxembourg at its meeting of 29 November 2017.

For the Court of Auditors



Klaus-Heiner LEHNE

President

Annex**Follow-up to the Court's recommendations in the Annual Report 2015**

The following table provides information on follow-up to the Court's recommendations in the Annual Report 2015:

Court's recommendations (paragraph 29 of the Report on the accounts of the European Schools for the financial year 2015)	European Schools		Central Office	Comments
	Frankfurt	Luxembourg I		
	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	
Recommendations on accounting issues				
The Schools should provide in-depth training and effective support for all those involved in the preparation of the accounts, in order to ensure that they are capable of meeting the legal deadlines for issuing them. Moreover the weaknesses mentioned above should be analysed and the possible effects on the 2016 accounts should be mitigated.	In progress			Training has been delivered and should continue in order to achieve the correct application of IPSAS (see also paragraphs 17 and 32).
Recommendations on staff issues				
The Central Office and the Schools should improve recruitment procedures (documentation should ensure legality, transparency and equal treatment).	In progress			Progress has been made, but weaknesses are still reported every year (see also paragraphs 18 and 33).
Recommendations on procurement issues				
The Court reiterates its recommendation from previous years for the Central Office to provide more guidance to the Schools on planning and designing procurement procedures. The Central Office and the Schools should follow the Financial Regulation and its Implementing Rules strictly, simplify selection and award criteria and improve the documentation for the procedures, so that transparency and equal treatment are ensured.	In progress			The 2016 audit found similar weaknesses to those found in previous years. A new procurement cell was created in 2016 at the Central Office (see also paragraphs 19 to 21 and 34).

Court's recommendations (paragraph 29 of the Report on the accounts of the European Schools for the financial year 2015)	European Schools		Central Office	Comments
	Frankfurt	Luxembourg I		
	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	
Recommendation on payments control system				
The Central Office should ensure that the segregation of duties is respected in the payment procedure and that an effective link is implemented between the new accounting system and the payment system in each individual School. Moreover the ex-ante controls applied should strictly follow the requirements of the General Framework.	In progress			A link has been established between the accounting software and the payment system for all Schools (see also paragraph 23).



REPLIES OF THE EUROPEAN SCHOOLS TO THE RECOMMENDATIONS OF THE COURT OF AUDITORS IN THE FRAMEWORK OF ITS ANNUAL REPORT FOR THE FINANCIAL YEAR 2016

Accounting

The European Schools provided in-depth training to the Accounting Officers of all the Schools on the closure of the 2016 accounts and focused on most common errors, which had been detected in the 2015 closure. A step-by-step closure manual was also disseminated. These trainings will continue in the future and will be adapted to changing needs in order to prevent errors in the closures of the schools. In this context, the remarks made by the Court and by the external auditor constitute very valuable feedback for further improving the quality of the accounts.

The European Schools note that the number of errors and their materiality in the 2016 Closure process are significantly lower than in 2015, the first year of implementation. In addition, a large majority of Schools were successful in providing their accounts to their respective administrative boards within the deadline of the Financial Regulation, March 31st (paragraph 15).

The OSG however submitted its financial statements only in May 2017. Following the removal to the new premises in 2016 and the lack of update to the inventory since early 2014, the decision was taken to completely re-do the inventory of the OSG. The late completion of this project explains the late finalization of the Financial Statements of the OSG.

The consolidated accounts were also finalized and transmitted within the legal deadline of June 1st, thus meeting one of the main remarks from the Court in its 2015 report.

Finally, the European Schools underline that the audits performed by an independent external auditor on five large schools (Brussels I, Brussels II, Brussels III, Brussels IV and Munich) expressed an unqualified audit opinion on their accounts. Based on these reports and on its own work, and after having checked that all corrections suggested by

the external auditor and by the Court have been correctly implemented, the Court concluded that it did not find any material errors in the 2016 Financial Statements.

Internal control systems

Recruitments procedures

The European Schools take note of the Court's recommendation and are of the opinion that the introduction of new guidelines on recruitment, which are in place since autumn 2015, have had a positive effect on the quality of recruitment procedures. The European Schools underline that the exceptions the Court refers to are in line with Article 5.5 of the AAS Regulations. Nevertheless, the OSG and the Schools will ensure that these exceptions are duly documented and justified.

Procurement procedures

The European Schools take note of the Court's recommendation and re-iterate their commitment to reducing inconsistencies and errors.

The OSG would like to underline that significant progress has been made since the creation of the procurement cell in mid-2016 and of the procurement network at the end of 2016. The observations of the Court mostly relate to procurements that were completed before the formation of these two bodies.

Following the adoption of the Financial Regulation on September 5th, where a complete alignment is foreseen with the procurement rules of the EU Financial Regulation, the Procurement cell is undergoing a complete revision of the documents to be used by the Schools for each type of procedure, and specific training is being provided to the Schools for this matter in the framework of the meetings of the procurement network. The new procedures and documents are made available by means of a dedicated Shared-Point site, available to all users. The objective is to finalize the project by the date of entry into force of the new Financial Regulation, on January 1st 2018. In addition, the full alignment and direct applicability will offer the European Schools the possibility to use the Commission's Help Desk and the subsequent services in interpreting and applying properly the relevant rules on tendering procedures.

Concerning inter-institutional framework contracts, a new centralized system for their conclusion and implementation by the individual schools, including management of quotas, has been set up and communicated to the Procurement network on October 17th 2017. A Memorandum on Framework Contracts will be transmitted to the schools within November 2017.

Finally, regarding extra-budgetary activity, a consulting engagement is to be performed by the Internal Audit Service of the European Commission (IAS) as from November 2017 on the "Management of the extra budgetary accounts in the European Schools". On the basis of the results of this engagement, it is the intention of the OSG to issue guidance on the matter, including also the procurement aspect.

Finally, regarding extra-budgetary activity, a consulting engagement is to be performed by the Internal Audit Service of the European Commission (IAS) as from November 2017 on the “Management of the extra budgetary accounts in the European Schools”. On the basis of the results of this engagement, it is the intention of the OSG to issue guidance on the matter, including also the procurement aspect.

Payments procedures

The European Schools take note of the Court’s observation regarding payments and, in particular, would like to underline the successful deployment of an automatic link between the accounting and banking software for all Schools.

Regarding payment procedures, the OSG would like to underline the improvements with respect to previous years and to re-iterate its commitment to pursue efforts to minimize errors. In this context, trainings have been delivered to Authorizing Officers, their deputies and vericators during the course of 2016 and 2017, where all important transactions have been reviewed and the main means of control underlined.

Finally, a new project has been launched where the profiles of all financial actors and related workflows will be revised and adjusted in the accounting software SAP in order to fully meet segregation of duties rules and principles in SAP, including the centralization of the roles of the Authorizing Officer and Accounting Officer functions.



Giancarlo MARCHEGGIANO
Secretary-general